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DEPARTMENT OF STATE

Washington, D.C. 20520

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August 24, 1981

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TO : Addressees Listed Below

SUBJECT: Discussion Paper for SIG Meeting on East-West Economic Relations

Attached is the paper corresponding to agenda item 2 in the Department's August 21 notification of a SIG meeting on East-West Economic Relations. The paper is circulated for information, not as a basis for decisions.

A paper corresponding to agenda item 1 will follow by separate cover.

L. Paul Bremer, III
Executive Secretary

List of Addressees:

OVP - Mrs. Nancy Bearg Dyke
NSC - Mr. Allen Lenz
DOC - Ms. Jean Jones
DOD - Mr. Jay Rixse
JCS - LTC Edward Bucknell
Treasury - Mr. David Pickford
USTR - Mr. David Macdonald
DOE - Mr. Peter Borre
25X1 CIA - [redacted]
UNA - Amb. Harvey Feldman

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State Dept. review completed

I. U.S. Measures To Reduce European Perceived Requirements For Soviet Gas

The most promising U.S. actions fall into four categories: coal, nuclear, gas and oil. A number of questions need to be answered regarding the prospects for U.S. action.

COAL

1. To what extent will market forces promote substitution of coal for gas, particularly as German quotas on coal imports are removed?

2. Would expedited coal port development significantly increase the prospects for coal substituting for gas? Which ports are crucial? What levels of expeditures or changed government policies would significantly expedite development of those ports? How much would specific changes in policies or levels of government spending affect European coal consumption and gas use?

3. Would it be feasible for the U.S. Government or coal producers to guarantee coal delivery to European customers even in the event of a miners' strike or a national emergency? What would these measures cost? Would they increase European coal consumption and decrease European gas use?

4. What levels of subsidies of coal prices for long-term contractors would significantly increase substitution of coal for gas? How might these subsidies be provided?

NUCLEAR POWER

1. What measures could the U.S. undertake to advance a political/technical solution to Europe's waste disposal impasse?

2. Would an expanded cooperation on waste disposal technology and means to gain public acceptance improve the near term prospects for increased European dependence on nuclear power?

3. Could the U.S. offer temporary storage options for European waste that would increase European willingness to rely on nuclear power? What would the costs be? To what extent would this reduce perceived European needs for Soviet gas?

4. Could the U.S. provide a long-term waste disposal option? How would this affect European nuclear plans and perceive needs for Soviet gas? What would it cost?

5. Would U.S. concessions on uranium enrichment or nuclear licensing policy improve the near term prospects for nuclear power?

GAS DECONTROL

1. How would expedited deregulation affect (a) total U.S. gas consumption; (b) total U.S. gas imports; (c) total U.S. oil consumption and imports; (d) prospects for U.S. imports of long haul LNG? How would these development in turn affect Europe's gas supply prospects and perceived need for Soviet gas?

2. Does the USG have regulatory authority to indicate that we will not import LNG from Africa? How would this affect European gas prospects and perceived need for Soviet gas?

OIL AND PRODUCT EXPORT DEREGULATION

1. Would elimination of barriers to U.S. crude oil and oil product exports change the Japanese oil import picture? How would those changes in turn affect European oil import prospects and prospective European demand for Soviet gas?

2. Would eliminating prospective barriers to the export of synthetic fuels encourage significantly increased European investment in the U.S. synthetic fuels industry? Would this affect longer-term European energy plans in general, and their willingness to forego long-term contracts for large scale Soviet gas export in particular?

II. European Measures To Reduce Perceived Requirements For Soviet Gas (The Case of West Germany)

INDUSTRIAL ENERGY DEMAND

The FRG projects a 15% increase in total final industrial energy demand over the next decade.

1. What is the technical basis of this projection? Is it high, in light of the fact that energy use in industry in both the FRG and the U.S. declined between 1973 and 1979 even though there was a substantial increase in industrial output? Could industrial gas be reduced by establishing fiscal incentives for investments which save energy (similar to the 1978 U.S. energy tax credits) or which involve conversion to coal (as done by French)? What are the prospects for accelerating the use of electricity by industry if new nuclear and coal fired power plants are built? What can be done to accelerate construction of these plants?

RESIDENTIAL ENERGY DEMAND

West Germany projects an increase in residential natural gas use of 34% over the next decade. This increase of gas use is expected even though overall energy use in the residential sector is expected to fall slightly.

1. What is the prospect for an even sharper fall in residential energy demand?

2. What are price relationships between heating oil and natural gas used for home heating? What would they be if gas was imported at a crude oil parity border price?

3. Would it be economically sensible and prudent to slow the expected fast pace of switching from oil to gas for residential heating?

4. Could residential energy demand be reduced further through conservation incentives?

III. Safety Net

In order to begin serious discussion of what measures should be included in a safety net, we need to assess what types and degrees of European vulnerability the pipeline would create, to what degree is it necessary to reduce those vulnerabilities, and what measures could be included in a safety net.

European Vulnerability

1. To what degree would the Europeans depend on Soviet gas and other energy resources? Would any specific regions or industries be particularly dependent?

2. If the Europeans do not construct any safety net, what would be the economic, social, strategic and political consequences of a Soviet gas cut-off? Which countries, regions and industries would be affected most severely?

3. What are the prospects for a joint cut-off of Soviet gas and Middle Eastern oil, or Soviet gas and North African gas? What would the consequences be?

Reducing Vulnerabilities

1. How many days reserve storage, surge and delivery capacity are required to alleviate the immediate effects of a Soviet cut-off?

2. How many days capacity of supplemental supplies, emergency management procedures, and demand restraint measures are needed to alleviate the medium term effects of a Soviet cut-off?

Measures

We need to consider the effectiveness and the cost of:

a) stored reserves

b) emergency surge and delivery capacity

c) maximizing dual-fire capabilities among industrial and commerical gas users

d) restrictions on the use of incremental gas to industrial and commercial users

e) a stock of fuel oils, beyond the current 90 day minimum to allow allocation of strategic gas reserves to those users which cannot shift to other fuels.

f) emergency demand restraint measures

g) a European gas sharing agreement which would tie into the EC oil sharing systems in the event of a concurrent shortage of oil and gas.